IN THE HIGH COURT OF JUDICATURE
ANDHRA PRADESH
AT HYDERABAD

THE HON'BLE SRI JUSTICE J.CHELAMESWAR
AND
THE HON'BLE SRI JUSTICE D.APPA RAO

WP No. 1278 of 2006

Between :

M/s. Larsen & Toubro Limited and Another .. Petitioners

And

State of Andhra Pradesh rep. by its Principal Secretary, Revenue - Finance, Government of Andhra Pradesh, Hyderabad, Andhra Pradesh and five others .. Respondents

WP No. 7998 of 2006

Between :

M/s. Clough Engineering Limited .. Petitioner

And

Government of Andhra Pradesh rep. by its Secretary, through its Department of Finance, Government of Andhra Pradesh, Hyderabad, Andhra Pradesh and two others .. Respondents

Dated : August, 2006

JUDGMENT : (per JC,J)

These two writ petitions raise an identical issue. Therefore the facts in WP No. 1278 of 2006 are taken as

representative facts and the writ petition is filed with the prayer as follows :

> "For the reasons stated in the accompany affidavit it is prayed that this Hon'ble Court may pass Writ of Mandamus or any other appropriate writ, order or direction under Article 226 of the Constitution of India, declaring that Section 22(3) & (4) of the Andhra Pradesh Value Added Tax Act, 2005 along with Rule 18(1) of the Andhra Pradesh Value Added Tax Act, 2005 and Explanation VI of Section 2(28) along with Section 2(29)(c)(i)(a) and Rule 17(2)(k) are *ultra vires* and beyond the legislative competence of the State of Andhra Pradesh under Serial No. 54, List II of the Seventh Schedule of the Constitution of India being violative of Serial No.92-A of the Union List and Articles 269(1)(g) and 286, and Sections 3, 4 and 5 of the Central Sales Tax Act, 1956 besides being *ultra vires* Article 266(29A) and the said provisions being inconsistent with Articles 14, 19(1)(g) are inoperative, and the recoveries under the said provisions are violative of Article 265 and 300A of the Constitution of India or pass such further or other orders or directions as may deem fit and proper in the circumstances of this case, and render justice."

The 1st petitioner is a limited company and the 2nd petitioner is a share holder of the 1st petitioner company. The 1st petitioner company is involved in different business activities like manufacturing, trading, execution of works contract, etc. They are executing the various projects on turnkey basis in the State of Andhra

Pradesh either for the State or various departments of the Government of India. According to the petitioner, in the process of execution of such contracts, one or some of the following factors

(i) Specific contract even without involving transfer of property in goods and thus not liable to levy of tax under the Act, yet will be subjected to tax deduction at source.

(ii) Supply of specific goods as per the terms and conditions of contract in the nature of `sale in the course of Inter-State trade or commerce," liable to levy of CST in the dispatching State. Though not exigible to taxation jurisdiction of Andhra Pradesh yet may be subjected to tax deduction at source under APVAT Act.

(iii) Specific nature of work relating a particular contract being entrusted on back-to-back basis to regd. Sub-contractors who under the scheme of APVAT Act while will be liable to tax, yet the petitioner being the main contractor despite their no tax liability may be subjected to tax deduction at source under APVAT Act

are invariably present in such contracts. The 1st petitioner is a registered dealer both under the APVAT Act, 2005 (VAT Act) and the Central Sales Tax Act, 1956. It is further asserted that the petitioner has been regularly filing prescribed returns under the above mentioned Acts. It is further stated in the affidavit filed in support of the writ petition that the assessments of the 1st petitioner are completed under the VAT Act for the assessment years 2001-2002 and 2002-03 resulting in a refund of Rs.77,77,522/- and Rs.97,99,619/- respectively. The said amounts were deducted by the employer/contractee at the time of payment of bills of the petitioner pursuant to the various provisions of the VAT Act which are impugned in the present writ petitions.

It is argued by the learned counsel for the petitioner that the provisions of Section 2(28) Explanation VI and Section 22(3) & (4) are beyond the competence of the Legislature of Andhra Pradesh apart from being violative of Article 286 of the Constitution

read with Sections 3 and 4 of the Central Sales Tax Act. Broadly the scheme of the Act insofar as it is relevant for the present purpose is as follows :

Under Section 4[1] of the Act, every dealer registered or liable to be registered as a VAT dealer is liable to pay tax on every sale of goods in the State at the rates specified in the schedules. Under sub-section (3) every dealer shall pay tax on the sale price at the rate specified in the schedules III, IV and V (subject to provisions of Section 13). Under Section 22(3) of the Act, in the case of a dealer executing work contract for government or local authority, tax at the rate of 4% is required to be deducted from the amount payable to the dealer by the contractee and remitted to the State in the prescribed manner. Under sub-section (4), a similar obligation is imposed on the contractee who happens to be either a company or a statutory body etc.[2] Under Section 2(28) Explanation VI, it is stipulated that whenever goods are supplied or used in the execution of a works contract, there shall be deemed to be transfer of property in such goods.[3]

As already noticed from the pleadings, according to the petitioners assertion, in the execution of various contracts undertaken by the petitioner one or some of the three elements indicated earlier exist which takes the transaction beyond the State's taxing power exist and therefore the learned counsel for the petitioner argued that the above mentioned provisions of the VAT Act which make it obligatory on the contractee to deduct the specified amount from out of the payments due to the petitioner under the contracts where there is no taxable event is nothing but extraction of money without ascertaining the facts whether the

petitioner is in fact liable to pay the tax and if the petitioner is liable the exact amount which the petitioner is liable to pay.

In support of his submission, learned counsel for the petitioner relied upon the judgments of the Supreme Court in **Steel Authority of India Ltd. v. State of Orissa**[4] and also **Nathpa Jhakri Jt. Venture v. State of Himachal Pradesh**[5].

In the 1st of the above mentioned cases, the Supreme Court was dealing with Section 13AA of the Orissa Sales Tax Act which provided for deduction at the source by the contractee an amount of 4% of the sum payable under a works contract. Section 13AA of the Orissa Act was held unconstitutional by the Orissa High Court in its decision reported in **Brajendra Mishra v. State of Orissa**[6]. The gist of the Orissa High Court's decision was summarized by the Supreme Court as follows :

> "…The High Court held that Section 13-AA did not provide any mechanism to exclude a transaction from its purview even if, ultimately, the transaction was not at all liable to the levy of sales tax. In other words, even in the case of a pure and simple labour contract or service contract where the question of sale would not arsie, the person responsible for making any payment to a contractor had no option but to deduct two per cent of such sum towards sales tax. Though a transaction which might not be a sale at all was made liable for levy of sales tax, yet in respect of that transaction power had been conferred to make deduction of two per cent from the amount to be paid. In the absence of any discretion with the authority and in the absence of any mechanism by which the contractor could approach any authority and obtain a certificate to the effect that the transaction did not amount to a sale, the

deduction of two per cent from the amount could not but be held to be grossly discriminatory and confiscatory in nature and, therefore, the same had to be struck down. The High Court added that by conferring arbitrary, unbridled and uncanalised powers on the person concerned to deduct two per cent from the sum payable to the contractor, irrespective of the question whether, ultimately, the transaction was liable for payment of any sales tax at all, could not be held to be a levy of tax under any valid legal provision. It was true that the deduction of two per cent under Section 13-AA was to be ultimately adjusted where the transaction in question was liable for levy of sales tax, but where the transaction was not at all liable for levy of sales tax, there the question of adjustment would not arise and, therefore, the deduction would be confiscatory in character and effect and it could not be held to be a valid provision within the legislative competence of the Legislature imposing the tax and authorizing the collection thereof. A bare reading o section 13-AA made it explicitly clear that the amplitude of the incidence of tax had been widened so as to include transactions which were outside the sphere of taxation available to the State Legislature under entry 54 of List II of the Seventh Schedule to the Constitution. Inasmuch as even in respect of a purely labour contract or service charges, section 13-AA authorized deduction of two per cent from the bills of the contractor, it could not but be held to be unconstitutional and void."

The State of Orissa accepted the decision of the High Court and replaced Section 13AA which read as follows :

"13AA. Deduction of tax at source from the payment to works contractors.- (1) Notwithstanding anything contained in

section 13 or any other law or contract to the contrary, any person responsible for paying any sum to any contractor (hereinafter referred to in this section as the `deducting authority') for ***carrying out any works contract***, which involves transfer of property in goods in pursuance of a contract between the contractor and-

(a) Central Government or any State Government, or

(b) any local authority, or

(c) any authority or corporation established by or under a statute, or

(d) any company incorporated under the Companies Act, 1956 (1 of 1956) including any State or Central Government undertaking, or

(e) any cooperative society or any other association registered under the Societies Registration Act, 1860 (21 of 1860).

shall, at the time of credit of such sum to the account of the contractor at the time of payment thereof in cash or by issue of a cheque or draft or any other mode, whichever is earlier, ***deduct an amount*** towards sales tax ***equal to four per cent of such sum in respect*** of the works contract, if the value of the works contract exceeds rupees one lakh.

(2) While making deduction as referred to in sub-section (1), the deducting authority shall grant a certificate to the contractor in the form prescribed and shall send a copy thereof to the Sales Tax Officer within whose jurisdiction the works contract is executed.

(3) The amount deducted from the bills or invoices shall be deposited into the Government treasury within one week from the date of deduction in such form or challan as may be prescribed.

(4) Such deposit into the Government treasury shall be adjusted by the Sales Tax Officer towards the sales tax liability of the contractor and would also

constitute a good and sufficient discharge of the liability of the deducting authority to the contractor to the extent of the amount deposited.

(5)(a) Where, on an application being made by the contractor in this behalf, the Commissioner is satisfied that any works contract of the nature referred to in sub-section (1) involves both transfer of property in goods and labour or service, or involves only labour or service and, accordingly, justifies deduction of tax on a part of the sum in respect of the works contract or, as the case may be, justifies no deduction of tax, he shall, after giving the contractor a reasonable opportunity of being heard, grant him such certificate as may be appropriate, in the manner prescribed :

Provided that nothing in the said certificate shall affect the assessment of the sales tax liability of the contractor under this Act.

(b) Where such a certificate is produced by a contractor before the deducting authority, until such certificate is cancelled by the Commissioner, the deducting authority shall either make no deduction of tax or make the deduction of tax as the case may be, in accordance with the said certificate.

(6) If any person contravenes the provisions of sub-section (1) or (2) or (3) or of clause (b) of sub-section (5), the Sales Tax Officer shall, after giving him an opportunity of being heard, by an order in writing impose on such person penalty not exceeding twice the amount required to be deducted and deposited by him into Government treasury."

(emphasis supplied)

It is the constitutionality of the said amended Section 13AA which fell for consideration of the Supreme Court. It can be

seen from sub-Section 5(a) of the said provision provided for the issuance of a Certificate by the Commissioner where deduction at source by the contractee are justified or not after an appropriate enquiry. Ostensibly this provision was introduced in a bid to overcome the observation made by the High Court that the absence of any discretion in any authority and existence of mechanism by which the contractor could approach and obtain a Certificate whether on the facts and circumstances of a given contract, deduction at source by the contractee is justified or not. Even on the face of the existence of such a provision, under sub-Section (5)(a) the Supreme Court held the provision unconstitutional. At para 9, the Supreme Court held as follows :

> "9. …. Sub-section (5)(a) permits the contractor to make an application to the Commissioner of Sales Tax and if the Commissioner is satisfied thereon that any works contract `involves both transfer of property in goods and labour or service or involves only labour or service and, accordingly, justifies deduction of tax on a part of the sum in respect of the works contract or, as the case may be justifies no deduction of tax, he shall, …. Grant him such certificate as may be appropriate in the manner prescribed.' To the extent of the amount mentioned in the certificate the owner must, by reason of sub-section (5)(b), make no deduction of tax. The Commissioner is required only to see whether the works contract involves transfer of property in goods and labour or service or only labour or service. If it involves only labour or service, he must certify that no deduction of tax shall be made and if it involves both transfer of property in goods and labour or service, he shall certify the deduction of a part of the sum payable by the owner to the

contractor. Sub-section (5)(a) takes no account of the fact that even if a works contract involves both transfer of property in goods and labour or service, State sales tax may not be payable upon the entire value ascribable to the transfer of property in goods for the reason that it is in the course of inter-State sales, outside sales or sales in the course of export, nor is such account taken elsewhere in Section 13-AA."

The Supreme Court further held at para 13 as follows :

"13. There can be no doubt, upon a plain interpretation of section 13-AA that is enacted for the purposes of deduction at source of the State sales tax that is payable by a contractor on the value of a works contract. For the purposes of the deduction neither the owner nor the Commissioner who issues the contractor a certificate under section 13-AA(5) is entitled to take into account the fact that the works contract involves transfer of property in goods consequent upon of an inter-State sale, an outside sale or a sale in the course of import. The owner is required by section 13-AA(1) to deposit towards the contractor's liability to State sales tax four per cent of such amount as he credits or pays to the contractor, regardless of the fact that the value of the works contract includes the value of inter-State sales, outside sales or sales in the course of import. There is, in our view, therefore, no doubt that the provisions of section 13-AA are beyond the powers of the State Legislature for the State Legislature may make no law levying sales tax on inter-State sales, outside sales or sales in the course of import."

and consequentially came to the conclusion that the provision is

required to be struck down on the ground it is beyond the legislative competence of Orissa State Legislature.

The 2nd of the cases relied upon by the learned counsel for the petitioner, a similar provision of Himachal Pradesh General Sales Tax was in challenge. The Supreme Court following the decision in **Steel Authority of India Limited's case (supra)** also struck down the impugned provision of the Himachal Pradesh General Sales Tax Act.

In our view, the issue involved in these writ petitions squarely falls within the teeth of the principle laid down in **Steel Authority of India's case (supra).**

We do not really need to examine the correctness of various factual assertions of the petitioners for adjudicating these writ petitions that in the process of execution of works contracts either there is no transfer of property in goods or in some cases though there is transfer of property in goods such goods were procured by the petitioners in the course of inter-State sale liable for Central Sales Tax Act. These are all facts required to be examined as and when the petitioners assessments are taken up by the respective assessing authorities, whether there is any taxable turnover in a given assessment period.

The Supreme Court in **Steel Authority of India's case (supra)** dealing with the legislative competence of a State in making a similar provision as the one impugned herein, the Court took note of the fact that such a provision does not take note of the fact that the gross amount payable by the contractee in a given case includes not only the value of the goods supplied if transfer of property in goods is involved, but also the value of the labour. Further the provision does not take note of the fact that such a

transfer of property in goods could be of the goods which are subject to Central Sales Tax Act if the procurement of such goods is in the course of inter-State sales, or in the case of export etc. The Supreme Court therefore came to the conclusion that the omission to take note of such factors and deducting certain amounts from out of the gross amounts payable to the dealer would be beyond the legislative competence of the State Legislature. The situation is identical in the case on hand.

In the circumstances, we have no option but to allow the writ petition declaring Sections 22(3) and (4) of the VAT Act unconstitutional and beyond the competence of the Legislature of the State of Andhra Pradesh. In view of the said conclusion, we do not deem it necessary to examine the constitutional validity of Explanation VI of Section 2(28) and Section 2(29)(c) (1a) and we leave the question open to be determined in a more appropriate case where there is more concrete factual foundation for the examination of the question.

(J.CHELAMESWAR, J)

(D.APPARAO, J)

August, 2006.

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[1] (4) Every VAT dealer, who in the course of his business purchases any taxable goods from a person or a dealer not registered as a VAT dealer or from a VAT dealer

in circumstances in which no tax is payable by the selling VAT dealer, shall be liable to pay tax at the rate of four percent (4%) on the purchase price of such goods, if after such purchase, the goods are –

(i) used as inputs for goods which are exempt from tax under the Act; or

(ii) used as inputs for goods, which are disposed of otherwise than by way of sale in the State or dispatched outside the State otherwise than by way of sale in the course of inter-State trade and commerce or export out of the territory of India; or

(iii) disposed of otherwise than by way of consumption or by way of sale either within the State or in the course of interstate trade or commerce or export out of the territory of India;

Provided that in respect of purchases of goods specified in Schedule III, the VAT dealer shall be liable to pay tax at the rate specified in that Schedule;

[2] **22. Due date for Payment of Tax :** (1) xxx

(2) xxx

(3) In the case of a dealer executing works contract for Government or local authority, a tax at the rate of 4% shall be deducted from the amount payable to him and such contractee deducting tax at source shall remit such amount in the manner as may be prescribed.

(4) In case of a VAT dealer executing works contract for a company or a statutory body or an undertaking or an institution other than Government or local authority irrespective of the quantum of value of the contract or for any other dealer or a firm where the value of the contract exceeds Rs.10,00,000/- (Rupees ten lakhs only), a tax at the rate of 2% shall be deducted from the amount payable to him and such contractee deducting tax at source shall remit such amount in the manner as may be prescribed.

[3] **Explanation VI :-** Whenever any goods are supplied or used in the execution of a works contract, there shall be deemed to be transfer of property in such goods, whether or not the value of the goods so supplied or used in the course of execution of such works contract is shown separately and whether or not the value of such goods or material can be separated from the contract for the service and the work done.

[4] [2000] Vol. 118 STC 297

[5] [2000] Vol. 118 STC 306

[6] [1994] Vol. 92 STC 17